McCarthy Asset Management, Inc.
Personalized Wealth Management

July 2015 Monthly Commentary

August 3, 2015

Stock Market & Portfolio Performance

Inside this issue:

July & YTD 2015: With the exception of small-caps, stocks rose for the month of July. Bonds were up modestly, and are now up slightly for the first seven month of 2015.

	July	YTD 2015	Description:
Without Dividends:			
S&P 500	2.0%	2.2%	500 Largest Public U.S. Companies
Russell 2000	-1.2%	2.8%	2000 of the smallest U.S. stocks
MSCI EAFE	2.0%	5.9%	international stock index
U.S. Aggr Bond	0.7%	0.6%	index of U.S. bonds
With Dividends, after all fees:			
MAM portfolios	0.4%	1.5%	non-very conservative MAM portfolios
MAM Conserv	0.0%	0.1%	portfolios with 50%+ bond allocation

Comment: After a drop early in July, stocks recovered with Greece receiving a temporary reprieve. Short-term risks remain, though, with the Fed likely to start raising interest rates in September.

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Recent Portfolio Adjustments

Value Funds Have Underperformed This Year: For the first seven months of 2015, growth stocks significantly outperformed value stocks. This can be seen by comparing the year-to-date performance of the Vanguard Russell 1000 Growth ETF (VONG), which was up 7.5%, to the Vanguard Russell 1000 Value ETF (VONV), which was down 0.2%. Because we are in the seventh year of a bull market, MAM portfolios are currently positioned to provide extra downside protection. Therefore, portfolios are over-weighted in value stocks and under-weighted in growth stocks.

Three of the value-oriented funds used by MAM (Schwab U.S. Dividend Equity (SCHD), Vanguard Dividend Appreciation (VIG), and the Yacktman Fund (YACKX)) have hurt portfolio performance this year. Both Schwab U.S. Dividend Equity and Vanguard Dividend Appreciation focus on stocks that pay an increasing dividend over time. Studies have shown that stocks that pay an increasing dividend have outperformed the stock market for longer time periods. Since both these ETFs are focused on similar stocks, a portion of SCHD was recently sold in a number of portfolios to establish a position in one of three PRIMECAP funds, which are focused more on growth stocks.

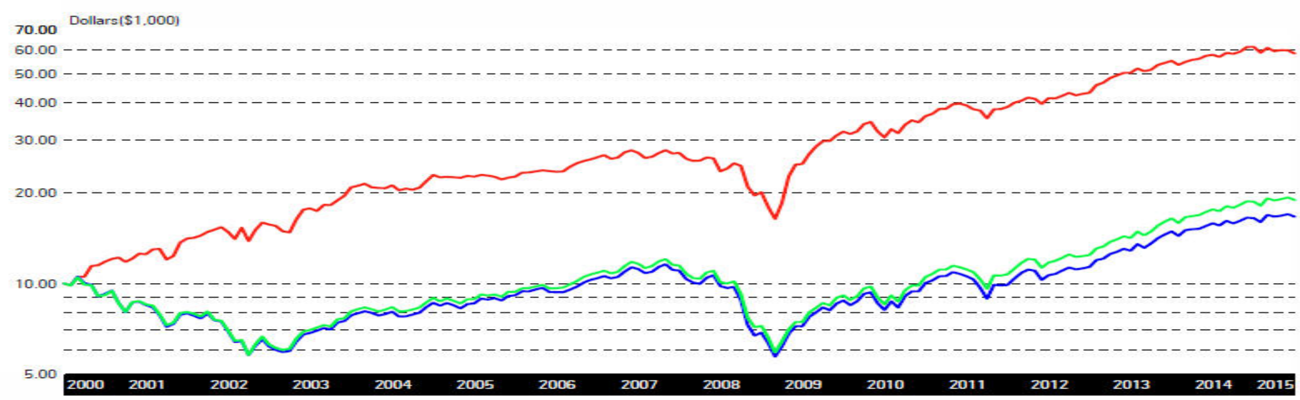
Discussion of the Yacktman Fund: The Yacktman Fund (YACKX) is a fund that invests in large-cap U.S. stocks. The Fund has underperformed the U.S. large cap blend index for the last five years, and is down a disappointing 3.9% for the first seven months of 2015. The Fund has an outstanding longer-term track record, however, performing in the top 3% of its peer group for the last 10 years and 1% for the last 15 years. From 7/1/2000 through 6/30/15, the Fund was up 483%, or 12.5% per year, compared to 89.6% for the S&P 500, or 4.4% per year. The chart below shows the performance of the Fund during this 15-year time-frame compared to the S&P 500:

Graph: Page 1 of 1 For internal and/or client reporting purposes only Release Date: 06-30-2015

Growth of $10,000:

Holding(s) from 07-01-2000 to 06-30-2015

Fund/Index	Total Return %	Annualized Return %	Amount at End of Period $
AMG Yacktman Service	482.95	12.47	58,295
Large Blend (MF)	66.84	3.47	16,684
S&P 500 TR	89.58	4.36	18,958



The Fund has performed very well through a full market cycle (i.e. a bull & bear market). But why has it performed relatively poorly the last few years? It is not because of a management change, as the father-son team of Don Yacktman & Stephen Yacktman continues to manage it (along with Jason Subotky). It is also not because the Fund has changed its strategy, as turnover in the portfolio continues to be very low, and the top five holdings as of March 31st were the solid blue chips PepsiCo, Procter & Gamble, Twenty-First Century Fox, Coco-Cola and Oracle Corp.

Downside Protection: The reason the Yacktman Fund has underperformed for the last five years is that the type of stocks it invests in ("defensive" stocks) outperform when stocks are falling and underperform when stocks are rising. Because the stock market has been on an incredible run since March of 2009, the Fund has underperformed during that time. I expect a portfolio allocation to this Fund will pay off in the next market downturn (the timing of which is too difficult to predict) as well as through a full market cycle. Here is how the Fund performed relative to the S&P 500 in the two years following the market peaks reached in 2000 and 2007:

Recent Portfolio Adjustments– Con't

	Cumulative Return 3/27/00 to 3/26/02	Cumulative Return 10/10/07-10/09/09
Yacktman Fund	57.71%	8.31%
S&P 500 Index	(23.56)%	(28.17%)

I am not predicting a new bear market (although we are overdue for a 10% market correction). Nonetheless, I think it is prudent to hold a fund such as Yacktman to protect portfolios for when stocks do eventually drop.

Addition of PRIMECAP to Larger Portfolios: In an effort to increase the exposure of portfolios to growth stocks (particularly technology and healthcare stocks), recently a position was established in a PRIMECAP fund in most portfolios of $350,000 and above. I don't plan to establish a position in smaller portfolios because Schwab charges a transaction fees for the purchase and sale of PRIMECAP funds (i.e. $25 for the purchase or sale of up to $27,000).

PRIMECAP is the manager of one of my favorite Vanguard funds (Vanguard Capital Opportunity), which has been closed to new investors for years. PRIMECAP has three of its own funds, the most aggressive of which, Odyssey Aggressive Growth, is also closed to new investors. Fortunately, since I already have a position in Odyssey Aggressive Growth, I can still purchase it for client portfolios. All three PRIMECAP funds have performed very well since they were introduced in 2004, as can be seen from the chart below:

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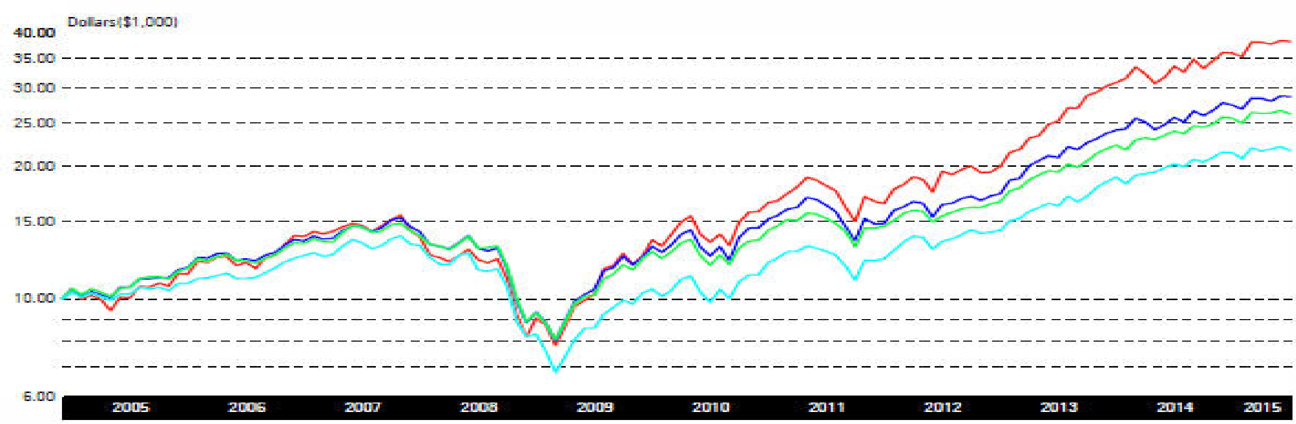
Growth of $10,000:

Holding(s) from 12-01-2004 to 06-30-2015

Fund/Index	Total Return %	Annualized Return %	Amount at End of Period $
PRIMECAP Odyssey Aggressive Growth	282.66	13.52	38,266
PRIMECAP Odyssey Growth	186.76	10.47	28,676
PRIMECAP Odyssey Stock	161.93	9.53	26,193
Vanguard 500 Index Inv	116.66	7.58	21,666



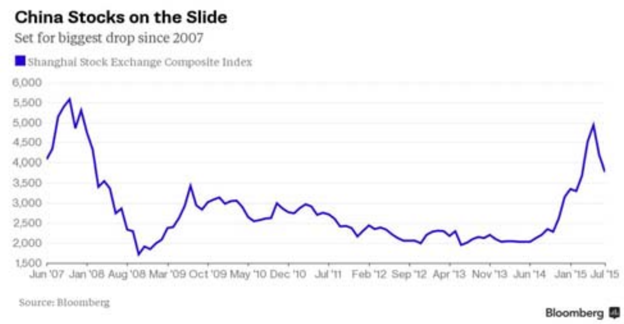
Which PRIMECAP fund was added to a specific client's portfolio was based on his/her risk tolerance:

- The Odyssey Aggressive Growth was added for more aggressive portfolios
- The Odyssey Growth was added for those clients with an average risk tolerance
- The Odyssey Stock was added for those clients with a more conservative risk tolerance

China Market Update

Boom & Bust: At its early June peak, the Shanghai Composite index was up over 150% year over-year and up over 100% just since the end of November 2014. But the rout that began after the June peak on June 12th took the index down 32% by July 8th. What is going on with this tremendous volatility and what is the significance for American investors?

Margin Debt- Cause of the Boom: At its recent peak, margin debt in China was up 463% year-over-year. That's a quintupling in less than one year—nothing like this has occurred anywhere since just before the 1929 crash in U.S. stocks. According to a July 13, 2015 article from Joseph Taylor of Loomis Sayles, "The scale of the margin borrowing was unprecedented…Currently, margin lending as a percentage of total market capitalization in Japan (1.5%) and U.S. (2.5%) is extremely conservative compared to China, where margin lending (both official and unofficial) at its peak was 15% to 20% of the free float."



Valuations: Mainland Chinese stocks ("A shares"), which trade on the Shanghai Stock Exchange and the Shenzhen Stock Exchange, are generally only available for purchase by mainland citizens (purchases for foreign investors is severely restricted). Hong Kong stocks ("H shares"), on the other hand, are traded primarily by global institutional investors. Mainland stocks received most of the boost, and bust, from buying on margin.

At the peak, mainland stocks in the Shenzhen Composite, where speculation was most rampant, traded at 60 times earnings versus 12 times for the MSCI China Index.

Unprecedented Interventions: Since the rout began, Chinese authorities—including the Communist government and the People's Bank of China (PBoC)—unleased unprecedented interventions to stem the decline:

- Cutting interest rates and bank reserve requirement ratios
- Suspending trading in a large percentage of "A-shares" (Chinese stocks listed onshore)
- Indefinite suspension of initial public offerings
- Restricting short sales
- Banning shareholders of over 5% from selling for six months

China's Economic Growth: For three decades, China's economy grew at an astonishing 10%+ annual rate. The last few years, the rate of annual growth has slowed to 7%. This slowdown is due to an economic transformation China is going through. Its three traditional engines of growth have all stalled at the same time: The real estate sector is contracting after a protracted boom; local governments needing to deleverage have scaled back their investment; and many components of the manufacturing sector have been shrinking. Chinese government officials are trying to replace these engines of growth with a rise in consumer spending, driven by rising wages.

Where Do We Go From Here: I am skeptical of the effectiveness of the efforts of the Chinese authorities to support their stock markets. Likely, what is needed is for the valuations of the mainland Chinese stocks to fall to a more reasonable level. Meanwhile, there may be an opportunity to invest in the H-shares traded in Hong Kong, as they have also been dragged down during the sharp decline, and now trade at the lowest relative valuation to the MSCI AC World Index in over 10 years. The primary exposure to Chinese stocks in MAM portfolios is via Matthews Asia Dividend Fund.

A Social Security Strategy for Couples: "File and Suspend"
By Lauree Murphy

In the January 2015 Monthly Commentary, we discussed reasons to delay taking Social Security until age 70 to maximize your lifetime benefits. This article addresses a strategy available to couples called "file and suspend".

Maximize Survivor Benefits:

For couples, an important aspect of Social Security planning is to maximize the survivor benefits. The spouse with the higher Social Security earnings should consider waiting until age 70 to collect. Regardless of who dies first, the higher benefit will be left to the survivor.

Spousal Benefits:

Married people can claim spousal benefits based on their partner's earnings record. This benefit allows a married person with little or no earnings history to receive a Social Security benefit. If the spouse applies at ***full retirement age (FRA),*** they get 50% of their partner's primary insurance amount. If they apply before full retirement age, they will get a permanently discounted benefit. In order for one to receive a spousal benefit, their partner must apply for Social Security benefits to trigger the spousal pay out. But what if your partner doesn't want to apply because they want to take advantage of deferred credits?

File and Suspend:

File and suspend involves one person filing for Social Security and then suspending their benefit. Why would you want to do this? Filing and suspending allows your spouse to begin receiving spousal benefits based on your Social Security record without you taking your benefit. This way one person can start receiving a spousal benefit, while the other lets their benefit continue to grow with deferred credits. Deferred credits add 8% a year to the benefit from full retirement age until age 70.

When both husband and wife have careers, they can let their benefits grow. One spouse "files and suspends" while the other "restricts their application" to a spousal benefit. That means they request that Social Security pay them only the spousal benefit and not their own benefit. When they reach age 70, they switch to the benefit that is based on their own working record. *While collecting the spousal benefit prior to age 70, the benefit based on their own earnings grows 8% per year.*

Limitations:

- You cannot file and suspend before full retirement age.
- Both of you can't file and suspend to get a spousal benefit. Only one person can take the spousal benefit.
- If you take a spousal benefit before FRA, your benefit is permanently reduced and you lose the option to get deferred credits between FRA and 70.

Since you cannot file and suspend before FRA, one of the important factors in whether this strategy will work is the difference in the ages of the two spouses. If the spouse with lower earnings is older, and their partner applies for their benefits before FRA to trigger spousal benefits, they permanently reduce their own higher benefit.

A Social Security Strategy for Couples: "File and Suspend" By Lauree Murphy– Con't

In this case it probably would make sense to just wait on the spousal benefits until the younger higher earner reaches full retirement age. Ideally, the person with the higher benefit wants to delay that benefit until age 70, to maximize the survivor benefit for whichever spouse lives longer.

As you can see, deciding the optimal time to take benefits can get complicated. If you are closing in on retirement, and want to know which Social Security strategies make the most sense for your particular situation, we can lay it out for you.

The "file and suspend" strategy is allowed now, but may not be around forever. There is talk that Congress may close this loophole

Sincerely,

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Our Services

McCarthy Asset Management, Inc. (MAM) is an independent, privately owned Registered Investment Advisor firm. We provide clients with the peace of mind that comes from knowing professionals are managing their financial affairs. The services we offer include:

Investment Management Services:

- **MAM creates and manages customized investment portfolios based on each client's investment objectives, timeframe and risk tolerance.**

Financial Planning Services:

- **The Net Worth Analysis (NWA) tracks the accumulation of Invested Assets for pre-retirees and the retention of Invested Assets for retirees. Updated annually.**
- **"Retirement Analysis" a comprehensive analysis of your retirement goals, which produces easy-to-read, interactive working plan, stored in the cloud. Updated as needed for life events.**

Tax Services: Clients have the option of utilizing the income tax services provided through the firm Stephen P. McCarthy, CPA. These services are offered at an hourly rate and may include:

- **Tax Return Preparation**
- **Income Tax Projections**
- **Tax Minimization Ideas**
- **Tax Authority Representation**

Other Services: MAM has retained several outside experts, whose services are available at no cost to our clients:

- **Long Term Care Planning– Allen Hamm of Superior LTC Planning Services, Inc.**
- **Medicare Advisory Program (MAP) - Allen Hamm**
- **The Savvy Life® Classes, Workshops , and One-on-One Consultations**

Reminders/Updates

Are you on course for a financially-comfortable retirement? A Retirement Analysis can be very helpful in answering that. Please let us know if you would like to have us prepare one for you.